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Byron Dorgan, Chairman

DEMOCRATIC POLICY COMMITTEE

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H.R. 8, the *Death Tax Elimination Act of 2000*

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Summary

The estate and gift tax is imposed on the transfer of assets between taxpayers. The gift tax is imposed on lifetime transfers to beneficiaries and the estate tax is imposed on transfers from an estate at death. A single tax rate schedule applies to the value of all transfers made by a taxpayer during his or her lifetime and the value of the estate at the time of his or her death.

On June 12, 2000, the House of Representatives passed **H.R. 8**, the *Death Tax Elimination Act of 2000.* The Senate is expected to consider **H.R. 8** during the week of July 10. The Finance Committee does not intend to hold a markup of the legislation.

Background

The estate tax is formally known as the unified estate and gift tax. The tax applies to the cumulative total of taxable gifts made during a person's lifetime plus transfers made from the estate upon a person's death. Nearly all debate on this issue has focused on the tax rates applied to transfers of assets to an heir from a decedent's estate.

The Gross Estate: The Federal Estate Tax Base

According to the Congressional Research Service, "The gross estate of a deceased individual includes both property owned by the decedent on the date of the decedent's death and certain interests in property which the decedent had transferred to another person at some time prior to the date of death."

Generally speaking, the value of the estate is determined by the fair market value of the property. However, there are a number of different valuation calculations that apply to specific types of property – such as real estate – that can be used to lower the value of the estate.

Deductions From the Gross Estate

Current law provides taxpayers with ways to reduce their estate tax liability. All estates — such as those consisting of financial investments, art collections, and other types of property — are eligible to claim the unified credit ($675,000 this year). Qualified small businesses and farms with a value of less than $1.3 million ($2.6 million for a business or farm owned by a married couple) are excluded from the estate tax. It is estimated that 98 percent of all estates are not subject to taxation through the use of either the unified credit or the $1.3/$2.6 million exclusions.

In addition, the owner of an estate may give annual gifts of up to $10,000 tax-free from the estate while they are living. Close relatives and charitable organizations are the most common recipients of these annual gifts.

Deductions From the Gross Estate — Unified Credit

The unified credit offsets any taxes paid on an estate and, correspondingly, exempts a portion of the estate from taxation. Prior to the *Taxpayer Relief Act of 1997*, estates with less than $600,000 in value were exempted from taxation by the unified credit. *The Taxpayer Relief Act of 1997* increased the unified credit from $600,000 to $1 million *per spouse* over a ten-year period by the following schedule:

For Decedents and Gifts During Exclusion	Applicable Credit Amount	Applicable Amount
1997	$192,800	$600,000
1998	$202,050	$625,000
1999	$211,300	$650,000
2000	$220,550	$675,000
2001	$220,550	$675,000
2002	$229,800	$700,000
2003	$229,800	$700,000
2004	$287,300	$850,000
2005	$326,300	$950,000
2006 and thereafter	$345,800	$1,000,000

Deductions From the Gross Estate — Exclusion for Family Businesses and Farms

For deaths occurring after 1997, qualified family-owned business interests (QFOBI) with a value of $1.3 million ($2.6 million for married couples) or less are excluded from the estate tax. The $1.3 million exclusion is separate from the unified credit and cannot be used in conjunction with the unified credit. In order to qualify for the $1.3 million exclusion as a QFOBI, a number of criteria must be met. The most important of the criteria is that qualified heirs of the estate must include members of the decedent's family or any individual who has been actively employed by the business for at least ten years prior to the date of death.

Estate Tax Rates

There is a graduated schedule of estate tax rates in which the tax rate increases along with the value of the estate. The rates range from 18 percent for taxable estates below $10,000 in value to 55 percent for estates worth over $3 million. For estates worth between $10 million and $17.184 million, there is an additional five percent surtax. Thus, for those estates, the marginal tax rate is 60 percent. Because the unified credit exempts all estates less than $675,000 from taxation, the lowest tax rate is 37 percent. When the unified credit reaches $1 million in 2006, the lowest tax rate will be 41 percent.

Generation-Skipping Transfer Tax

Current law also contains the generation-skipping transfer tax. This tax is imposed on the transfer of assets through a trust or similar arrangement to a "skip person." A skip person is a beneficiary more than one generation removed from the trust owner. Each 25-year period is treated as a new generation. For example, a grandchild would be designated as a skip person if they received assets from a trust established by a grandparent. The generation-skipping transfer tax is imposed at a flat rate of 55 percent on all transfers.

Major Provisions

Title I — Repeal of Estate, Gift, and Generation-Skipping Taxes; Repeal of Step Up In Basis At Death

Title I of **H.R. 8** would repeal the taxes on estates, gifts, and generation skipping transfers for any death occurring after December 31, 2009.

Title I also would replace the current step-up basis method used to calculate the value of an estate with a modified carryover basis regime. Current estate tax law permits a step-up in the basis of an inherited asset. For the heir or recipient, the basis is the value of the asset on the decedent's date of death. By comparison, a carryover basis generally would be the value of the original price of the asset when it was purchased by the decedent.

The following example can be used to describe the step-up basis and how **H.R. 8** would replace the step-up basis in current law with a modified carryover basis:

- A mother purchases $10,000 in stock in 1969.
- Over 30 years, the value of the stock increases to $30,000.
- Upon her death, the mother's estate transfers the $30,000 in stock to her son.
- The son sells the stock for $35,000 in 2000.

Under current law, the basis of the stock held by the son would be $30,000. Thus, he would only pay capital gains on $5,000 ($35,000 sale price - $30,000 price upon inheritance).

The report accompanying **H.R. 8** argues that the current law is flawed because, "This step-up in (or step-down) basis eliminates the recognition of any income on the appreciation of property that occurred prior to the decedent's death, and it has the effect of eliminating the tax benefit from any realized loss."

After the repeal of the estate tax on December 31, 2009, **H.R. 8** would replace the current method for determining the basis method in property with a modified carryover scheme. The modified carryover scheme would determine the value of the asset on its original purchase value. Using the example above, the carryover basis of the stock would be $10,000. This would result in the son paying capital gains on $25,000 from the sale of the stock.

Recognizing this change would result in taxpayers paying higher taxes on assets, **H.R. 8** would give beneficiaries the choice to exempt $1.3 million per spouse in transfers from the carryover basis and instead use the step-up basis as under current law. An additional $3 million of assets transferred to a surviving spouse would also be eligible to receive a step-up in basis under Title I of **H.R. 8**.

Title II - Phased-In Repeal of the Estate, Gift, and Generation-Skipping Transfer Taxes

Title II of **H.R. 8** would repeal the estate tax on estates inherited after December 31, 2009. For the nine years prior to 2010, the bill phases in the repeal of the maximum estate tax rates along the following schedule:

- For 2001, any rates above 53 percent are repealed.
- For 2002, any rates above 50 percent are repealed.
- For 2003 to 2006, all rates are reduced by one percent per year.
- For 2007, all rates are reduced by 1.5 percent.
- For 2008 to 2009, all rates are reduced by two percent. In addition, for 2009 the top rate for estates in excess of $3 million would be 40.5 percent.
- For 2010 and thereafter, the estate, gift, and generation-skipping transfer taxes would be repealed.

Title III - Replace Unified Credit With Unified Exemption

As previously mentioned, the unified credit currently allows the first $675,000 of an estate to be excluded from taxation. However, this means that the tax rate for estates in value above $675,000 are subject to a beginning tax rate of 37 percent, with a gradual increase to the maximum 55 percent rate.

Upon enactment, **H.R. 8** would change the unified credit to a unified exemption. For estates with a value above the unified credit, the tax rates would start at the lowest estate tax rate (18 percent) and gradually increase to the maximum estate tax rate. Once the repeal of the estate and gift tax becomes effective in 2010, this section would no longer apply.

Title IV - Modifications of Generation-Skipping Transfer Tax

Under current law, a generation-skipping transfer tax is imposed on transfers, either directly or through a trust or similar arrangement to a "skip person" (a beneficiary more than one generation removed from the transferor).

Title IV of **H.R. 8** would make a number of modifications to simplify the generation-skipping tax prior to its repeal in 2010.

Title V - Conservation Easements

The *Taxpayer Relief Act of 1997* included a provision that allows taxpayers to make an election to exclude from their taxable estate 40 percent of the value of any land subject to a conservation land easement. The purpose of this provision is to encourage the donation of environmentally-sensitive land for conservation purposes. The maximum exclusion for the current year is $300,000. In order to qualify, the land must meet the following criteria:

- the land must be located within 25 miles of a metropolitan area (as defined by the Office of Management and Budget) or within ten miles of a national park or wilderness area (as designated by the U.S. Forest Service);
- the land must have been owned by the decedent or the family of decedent for the three years prior to the decedent's death; and
- the land meets the definition of a "qualified contribution conservation contribution."

H.R. 8 would expand the availability of qualified conservation easements to land within 50 miles of a metropolitan area and 25 miles from a national park or wilderness area.

Revenue Effect of H.R. 8

According to the Joint Committee on Taxation's analysis, the revenue loss due to **H.R. 8** would be $28.3 billion over five years. It is estimated the revenue loss associated with **H.R. 8** over ten years would be approximately $105 billion. If the repeal of the estate and gift tax is fully phased in, the Department of Treasury estimates the loss to the federal treasury would be approximately $70 billion per year, and possibly tens of billions more.

Possible Amendments/ Democratic Alternative

A supplement to this bulletin will be issued that will summarize possible amendments and the Democratic estate tax alternative to **H.R. 8**.

Legislative History

On June 9, 2000, The House of Representatives passed **H.R. 8** by a vote of 279 to 136. **H.R. 8** was not considered by the Senate Finance Committee prior to the bill being placed on the Senate calendar.

Previous Votes

Provisions similar to **H.R. 8** were included in H.R. 2488, the *Taxpayer Refund and Relief Act of 1999*. On August 5, 1999, the Senate passed the conference agreement on H.R. 2488 by a vote of 50 to 49. President Clinton vetoed **H.R. 2488** on September 23, 1999.

Arguments For and Against

For: The current estate and gift tax rates impose such a burden on estates, many families are forced to liquidate the estate in order to pay for the taxes imposed on it. Furthermore, estate planning is a costly and complex undertaking that many families cannot afford.

If a family has accumulated wealth or a businesses over a period of time, the tax code should not prevent them from passing the assets to their children and grandchildren. Repealing the estate tax will ensure farms, small businesses, and other assets stay within families for many generations.

Against: Repealing the estate and gift tax will only benefit the wealthy few at an enormous cost to the federal treasury. Current law provides for a unified credit for all estates and a $1.3 million per-spouse exemption for family-owned businesses and farms. Combined with other provisions already in the tax code, the unified credit and the $1.3 million per-spouse exemption effectively exclude 98 percent of all estates from taxation. It is estimated that the top one-tenth of the wealthiest one percent of all estates will reap 50 percent of the benefits from repealing the estate tax.

Furthermore, the cost of **H.R. 8** explodes in the out years. **H.R. 8** costs $105 billion over the first ten years. That cost is estimated to explode to an average of $70 billion per year in the next ten years. The enormous revenue loss would make it difficult to address important priorities such as providing a Medicare prescription drug benefit and ensuring the long-term solvency of Social Security.

Position of Outside Groups

Groups Supporting H.R. 8

National Federation of Independent Businesses

American Farm Bureau

Chamber of Commerce

National Taxpayers Union

Groups Opposing H.R. 8

Center on Budget and Policy Priorities

Citizens for Tax Justice

AFL-CIO

Children’s Defense Fund

National Committee for Responsive Philoanthropy

Groups with No Position on H.R. 8

Committee for a Responsible Budget

American Red Cross

Statement of Administration Policy

On June 8, 2000, the Administration issued a Statement of Administration Policy (SAP) on **H.R. 8** before its consideration by the House of Representatives. In the SAP, the Administration stated that it “strongly opposes **H.R. 8**, which would repeal the estate and gift taxes. Repeal of these taxes would be fiscally unwise, would reduce the overall fairness and progressivity of the tax system, and would harm charitable giving. The President would veto this legislation repealing the estate and gift taxes if it were presented to him.”

[1]CRS Report for Congress, 95-416, “Federal Estate, Gift, and Generation-Skipping Taxes: A Description of Current Law,” May 11, 1999.